State of Wisconsin • DEPARTMENT OF REVENUE

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Scott Walker
Governor

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March 1, 2012

DOR Testimony in Support of Assembly Bill 638

Summary.

The Legislature created a state Manufacturing and Agriculture Tax Credit via 2011 Wisconsin Act 32. This provides a tax credit of 7.5% against taxes on income derived from manufacturing and agricultural production activity that takes place on Wisconsin property. It is similar to the federal Qualified Production Activities Deduction.

The Manufacturing and Agriculture Credit takes effect in 2013 and is equal to 1.875% of income derived from manufacturing and agricultural activities performed in Wisconsin. The credit is phased-in through 2016 and eventually reaches its maximum of 7.5%.

Prior to the effective date of 2013, technical adjustments are necessary to ensure that the credit is administrable by the Department of Revenue (DOR) and also to ensure that the administration of the credit is consistent with the Legislature's intent. Assembly Bill 638 does not have any fiscal effect and does not change the scope of the credit from 2011 Wisconsin Act 32. This technical legislation is necessary for three key reasons:

- The bill corrects a circular calculation that was included in 2011 Wisconsin Act 32.
- The bill provides certainty by providing bright lines for both DOR and taxpayers regarding this Wisconsin-specific credit.
- The bill removes unnecessary cross-references that were included in 2011 Wisconsin Act 32.

DOR has determined that clarifying legislation is desirable to make these changes so the credit can be implemented in accordance with the Legislature's intent.

Background.

More specific explanation follows of the three key changes created by Assembly Bill 638.

- Corrects a circular calculation that was included in 2011 Wisconsin Act 32.

  Currently, the credit requires a farmer or manufacturer to know income in order to compute the credit. However, the credit is a component of income in the year that the credit is claimed. Since both components depend on each other, DOR and taxpayers would have difficulty in correctly administering and receiving the credit.

  Assembly Bill 638 provides the following calculation instead.

  Step 1: Calculation of Eligible Qualified Production Activities Income.

  Total Qualified Production Income x Manufacturing (or Agricultural) Property Factor = Eligible Qualified Production Activities Income.

  Comment: This step separates out the manufacturing and farming that is performed in Wisconsin from the manufacturing or farming that is done in other states. This ensures that the credit is Wisconsin-specific.

Step 2: Calculation of the Manufacturing and Agriculture Credit.

Eligible Qualified Production Activities Income x Phased-In Credit Amount = Manufacturing and Agriculture Credit.

Comment: Since this credit is phased-in over four years, the calculation will vary initially. The table below shows how the phase-in will work.

Taxable Year			
2013	Qualified Production Activities Income x	1.875% =	Manufacturing and Agriculture Credit.
2014		3.75% =	
2015		5.526% =	
2016 and beyond		7.5% =	

- Provides certainty for both DOR and taxpayers regarding this Wisconsin-specific credit.

  The credit currently references the federal Internal Revenue Code (IRC) as it applies to the federal Qualified Production Activities Deduction.

  This credit is Wisconsin-specific and is limited to agriculture and manufacturing. The referenced IRC section includes several other categories that the Legislature has not included in the Wisconsin-specific credit. These extra categories are explicitly excluded in the bill. These extra industries are not agriculture or manufacturing and would not have been able to successfully claim the credit since their income generation does not occur on land assessed as agricultural or manufacturing. However, their inclusion in the IRC creates ambiguity for this Wisconsin-specific credit.

- Removes unnecessary cross-references that were included in 2011 Act 32.

  Generally speaking, the Legislative Reference Bureau mirrors language for corporate income tax credits in the insurance statutes since the corporate and insurance sections are distinct. The reason for mirroring the language in both sections is that many of the corporate credits are also available to insurance companies.

  However, insurance companies do not engage in agricultural or manufacturing activities, and the cross-reference of the credit in the insurance statutes is unnecessary.

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March 2, 2012

Dear Representative Kerkman:

As a follow-up to yesterday's hearing on Assembly Bill 638, which the Department of Revenue authored to provide purely technical changes to the Manufacturing and Agriculture Credit, I am writing with further information about some of the questions that Committee members raised during the discussion on the bill.

Consistent with the testimony that Diane Hardt and I presented yesterday, **the Manufacturing and Agriculture Credit as clarified in Assembly Bill 638 is specific to income derived exclusively from activities in Wisconsin. Out of state income, non-agricultural income, and non-manufacturing income are <u>not</u> considered as eligible income for the purpose of claiming the credit.** Please see the definitions for "Agricultural property factor" (page 3, beginning on line 1 and page 7, beginning on line 20) and "Manufacturing property factor" (page 4, beginning on line 3 and page 8, beginning on line 13). Both of these factors use Wisconsin-generated income from agriculture/manufacturing in the numerator and all agriculture/manufacturing income in the denominator. The effect of using this factor separates out Wisconsin-specific eligible income from all other, non-qualifying income.

Assembly Bill 638 does not expand the scope of the credit beyond what was created in 2011 Wisconsin Act 32. The Manufacturing and Agriculture Credit is specific to those two industries. The federal Qualified Production Activities Deduction includes several other industries. While the Manufacturing and Agriculture credit has never included those extra industries, Assembly Bill 638 provides certainty to that point (see page 9, lines 20-25 through page 10, lines 1-4). **This Wisconsin-specific credit necessarily needs Wisconsin-specific definitions, which is the reason why the Department of Revenue has requested the definitions in Assembly Bill 638 instead of referring to the related, but not-equivalent section of the Internal Revenue Code.**

The Committee also discussed potentially changing the maximum credit rate of 7.5% to a lower percentage when this credit is fully phased-in during Tax Year 2016 over concern that the marginal tax rate of some potential claimants would be less than the credit allowed. Please consider the following:

- This credit is non-refundable, which means that if an eligible farmer or manufacturer does not have tax liability as a result of this credit, the farmer or manufacturer would not receive any sort of refund or rebate check from the Department of Revenue.
- However, as is the case for the vast majority of tax credits, the farmer or manufacturer could carry-forward the unused portion of the credit for up to 15 years to offset tax liability in a future year.
- **Corporations are specifically limited in this bill to claim the least amount of the following three categories**: eligible qualified production activities income (Wisconsin-specific as calculated in this bill); income apportioned to Wisconsin; or income determined as taxable in Wisconsin (see page 10, line 21 through page 11, line 2). **Additionally, the corporate tax rate exceeds the maximum credit amount.**
- Individuals do not face the same limits as corporations do under Assembly Bill 638. For example, as mentioned in our testimony, in cases where one spouse may have a credit that exceeds his/her agricultural income the credit could be used to offset the other spouse's tax liability from income from an occupation outside of the farm. This credit provides the same treatment as several others, including the Jobs Tax Credit, Dairy and Livestock Farm Investment Credit, and the Angel Investment Credit, in addition to a number of others.

- DOR believes that those whose marginal tax rate will be less than the credit amount would be farmers and small businesses.

Any amendment lowering the maximum credit amount or creating disparity between the maximum percentage that individuals and corporations could claim would be a significant policy decision. Regardless of any anticipated fiscal effect, such an amendment would be non-germane to the relating clause and content of Assembly Bill 638, which is limited to technical changes.

If the Legislature would like to alter the policy decision already determined regarding the maximum credit allowable to individuals in the fully phased-in credit year of 2016, the Department advises doing so via separate legislation. The scenario discussed by the Committee that would be addressed by such an amendment will not occur until 2016, which will be two full legislative sessions after the current one. **However, without the clarifying language in Assembly Bill 638, taxpayers and the Department will face uncertainty and difficulty in administering this credit, and we believe it is desirable to address these technical issues before the start of the 2013-2014 legislative session that begins next January.**

The Department of Revenue thanks Representative Kooyenga for introducing this technical bill at our request. Our goal in drafting Assembly Bill 638 was and continues to be to make technical changes to provide certainty to both taxpayers and the Department. Any amendments that have significant policy changes, such as those discussed during the Committee hearing, would change this bill's purpose as a purely technical piece of legislation. The Department is willing to provide feedback on the administrative effects of policy changes related to the Manufacturing and Agriculture Tax Credit, but we strongly recommend and advise that such changes should occur via separate legislation.

As always, please feel free to contact me with any further questions you may have. We appreciate the opportunity to appear and testify before the Assembly Committee on Ways and Means and for your consideration of our legislation and clarifying information.

Sincerely,

Michael Wagner

Michael Wagner
Legislative Advisor, Wisconsin Department of Revenue

cc: Assembly Committee on Ways and Means Members
Representative Dale Kooyenga
Senator Glenn Grothman